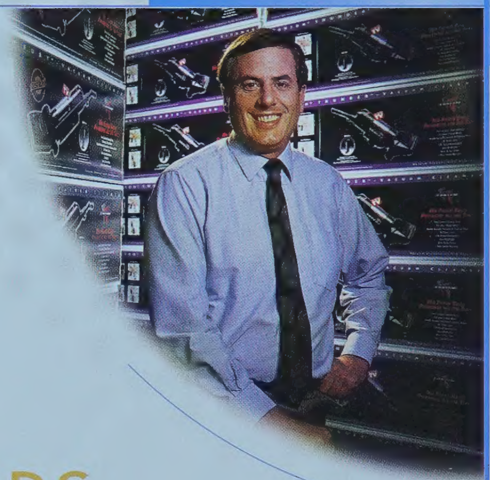
ANNUAL REPORT 1997

FANTOM®

OUR NEW NAME

THE COMPANY HAS A NEW NAME, FANTOM TECHNOLOGIES INC., WHICH TOOK EFFECT ON MAY 1, 1997, REPLACING OUR OLD NAME, IONA APPLIANCES INC. THIS CHANGE, APPROVED AT LAST YEAR'S ANNUAL SHAREHOLDERS' MEETING, ALIGNS OUR CORPORATE IDENTITY WITH OUR HIGHLY SUCCESSFUL AND EXPANDING LINE OF FANTOM® VACUUM CLEANERS.



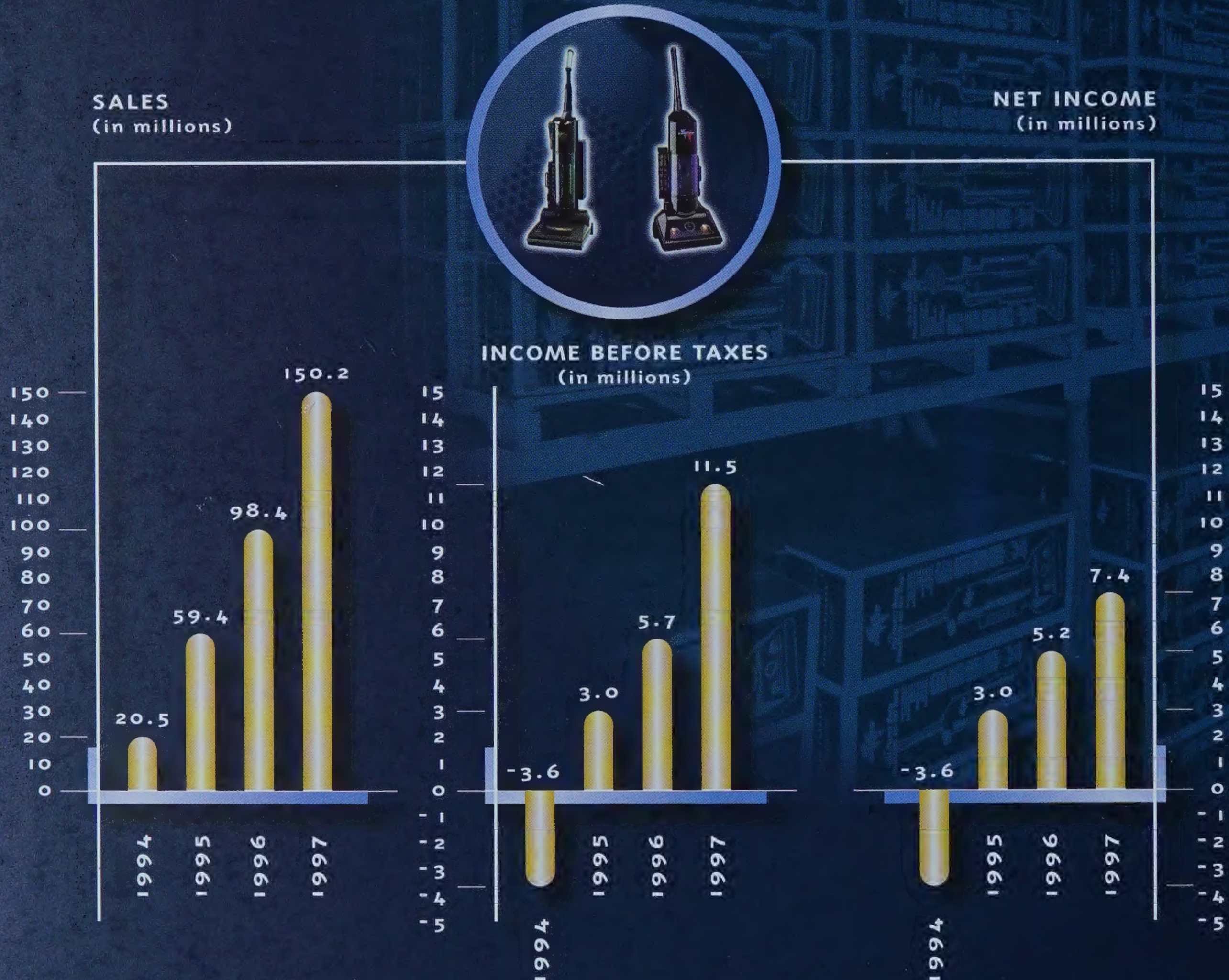
REPORT TO SHAREHOLDERS

Allan D. Millman, *President and Chief Executive Officer*

THIS YEAR'S REPORT IS ABOUT GROWTH:

GROWTH IN THE PAST TWELVE MONTHS, GROWTH PLANS FOR THE NEAR FUTURE, AND GROWTH EXPECTATIONS FOR THE LONG-TERM. IT IS ALSO ABOUT THE STRENGTH OF OUR ORGANIZATION AND THE SKILL-SETS WE HAVE PUT IN PLACE, SO THAT WE CAN CONTINUE OUR PROSPERITY.

OUR EXCELLENT YEAR



This year's performance marks the third straight year of outstanding results - the best year in our Corporate history. Revenue reached $150.2 million, a gain of 53% over last year's volume, and income before taxes reached $11.5 million, an increase of 101% over last year. After recognizing the effect of a $4.1 million tax provision this year, compared with $0.5 million last year, net income still improved by 41% to $7.4 million or 88¢ per share (based on 8,363,599 shares outstanding), compared to $5.2 million or 72¢ per share (based on 7,232,746 shares outstanding) in fiscal 1996.

Financial information in this report is expressed in Canadian dollars, unless otherwise noted.

We achieved these excellent results by sticking closely to our proven course of direct-response television advertising and strong merchandising through large mass merchants, catalog and catalog-showroom retailers, warehouse clubs, home-shopping television networks, and independent vacuum dealers. Only this year, we did more of it. We continued to air our 30-minute TV infomercial for the FANTOM® FURY® vacuum as well as short-form TV spots for both the FANTOM® FURY® and FANTOM® THUNDER® products. During the Spring, the Company began testing direct-response radio and print advertising in an effort to broaden our direct-response reach.

Recognition of our growing success came from influential industry sources. For the second time, the Company received a 'Best Buy' designation from Consumers Digest Magazine, an influential U.S. consumer publication, this one for the FANTOM® FURY® vacuum in the magazine's 1997 Annual Buying Guide issue. And our FANTOM® FURY® 30-minute infomercial was recognized as the 1996 'Best Demonstration Infomercial' by Jordan Whitney, Inc., a company that monitors and publishes reports on direct-response television activity in the United States. Once again, this was the second time the Company has been awarded this industry-noted prize.

Also during the year, the Company continued to expand its retail distribution, securing listings in the United States with Costco Wholesale Inc. (Price Costco), B. J. Wholesale Inc., Kohl's Department Stores, and Shopko Stores Inc. The FANTOM® vacuum now holds a major presence in large retail outlets across the U.S. marketplace. In Canada, we increased our investment in advertising and are positioned to realize significant increases in distribution in the months ahead.

CANADA:

Home Hardware Stores Ltd.
T. Eaton Co. Ltd.
The Shopping Channel

UNITED STATES:

ABC Warehouse
Allergy Asthma Technology Ltd.
B. J. Wholesale Inc.
Costco Wholesale Inc. (Price Costco)
CUC International (Comp U Card Services Inc.)
Damark International Inc.
Federal Employees' Distributing Company Inc. (Fedco)
Fingerhut Companies Inc.
Fred Meyer, Inc.
Home Shopping Network Inc.
JC Penny Company, Inc.
K's Merchandise Inc.
Kmart Corporation
Kohl's Department Stores
Penn Daniels Incorporated (Jack's Discount Center)
Sears, Roebuck and Co.
Service Merchandise Company, Inc.
Silvo Hardware Company
Shopko Stores Inc.
Solutions - A Division of Norm Thompson, Inc.
Spiegel, Inc.
Target Stores - A Division of Dayton Hudson Corporation
The Anderson Management Corp.
The Caldor Corporation

Clearly, there is growing awareness of and desire for the Company's line of FANTOM® vacuums by the consuming public. As we mentioned in last year's report:

'Our objective is...to command, within each segment in which we compete, the leading share of market.'

We have achieved this, based on the report from an independent, retail-auditing company that monitors vacuum-cleaner sales through retail outlets. The May-June 1997 audit reported that our line of FANTOM® vacuums controlled, by a large margin, the leading share of market among mass merchants within the premium-priced (U.S.$195 and over) segment of the U.S. upright vacuum-cleaner market (based on the auditing company's definition of mass merchants). Furthermore, our successful efforts have led to the expansion of the premium-priced segment.

Our Growing Shareholder Value

As we have expanded our business and achieved market-share leadership, we have also improved returns for our shareholders. The market price of our shares has increased in four short years from 95¢ as of June 30, 1993 to $14.65 as of June 30, 1997. During this same time period, our market capitalization has grown from $5 million to $131 million.

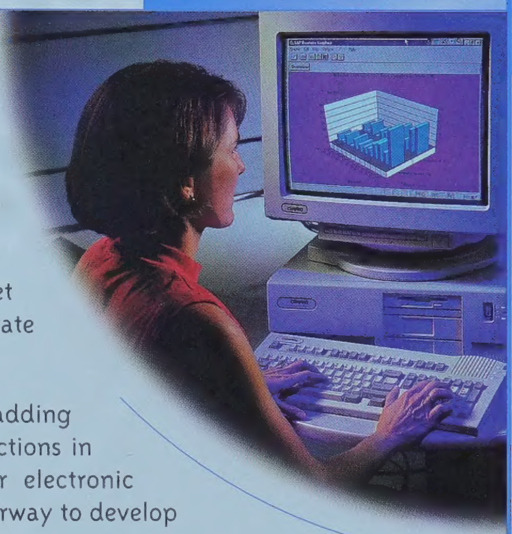
At the Forefront of Manufacturing Technology

To accommodate our large growth in sales volume, and to ensure that we maintain - and even improve upon - our high standards of product quality, we made significant changes to our manufacturing facility in Welland, Ontario. For instance, we expanded our production capacity by adding a third state-of-the-art, self-paced, automated assembly line, this one to handle the huge surge in demand for our FANTOM® THUNDER® vacuum. This new line has also been designed to act as a swing line and is capable of producing a new product that is planned for launch in the near future.

But the most important improvement in our manufacturing facility is one which is planned for completion by the end of this calendar year. The Company expects that it will earn the ISO 9001 registration, which represents achievement of a worldwide standard for quality processes and practices. It takes a long time to earn this designation, because every department in the Company must meet rigorous criteria. The designation we have been working towards, ISO 9001, is the most advanced registration of the ISO 9000 series, because it includes product design along with all functional activities. In working towards this important recognition, the Company has already benefited from the experience, as evidenced by an improvement in our production-line quality levels during the past year.

Information Technology: One Year of Life With SAP

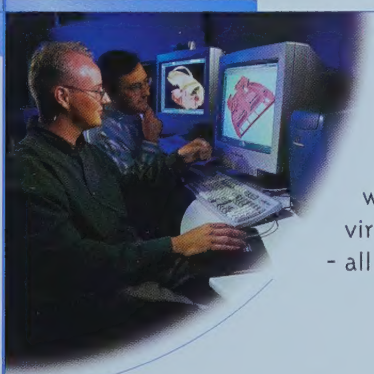
In last year's report, we announced that on the first day of our fiscal 1997 year we implemented throughout the Company the SAP enterprise-infomation-technology system, a fully integrated, business, software program that connects every department of the Company into a 'live' or 'real-time' mode of operation and problem solving. Now, with a full year's experience using SAP, we can report that it is working successfully. Also during the year, every employee using a computer at his/her desk became connected to the Internet, which means that each person can communicate through e-mail with anyone, anywhere, anytime. As well, the Company set up its own Intranet web site for employees to share corporate information internally.



In the upcoming year, we plan to expand SAP in the Company by adding sales-order planning, profitability analysis, and more functions in executive-information systems. We plan to extend our electronic commerce with vendors and customers. Plans are also underway to develop a first-class Internet web site for anyone outside the Company who wishes to learn about our Company or products.

Our Talented, New-Product Team

As new products are the driving force for our future growth, we have enhanced the resources to create them. We have expanded our marketing and engineering departments, and have complemented them with expertise from outside strategic partners.



As well, our engineering department underwent major changes in how it designs and develops the internal workings of new products with the installation of four CAD (computer-aided design) Silicon Graphics Inc. workstations, using Matra Datavision's highly-rated Euclid3 software. With this exceptional software, concurrent engineering becomes a reality. That is, we now have the ability to design mating parts at the same time, to visualize a virtual representation of any product and to produce prototype parts in 24 hours - all before any hard investment is made in production tooling.

THE BIG YEAR AHEAD

The Company's brand new product, the FANTOM® LIGHTNING® canister vacuum,

is the best evidence of our success in using the Euclid3 software. This dual-cyclonic machine, planned for launch in the Fall of 1997, is every bit as revolutionary in its design for the canister segment of the market as our current vacuums have been for the upright segment. It expands our

competitive thrust and presence of our FANTOM® brand name into a segment of the business in which we have not previously participated. We are optimistic that the FANTOM® LIGHTNING® vacuum will revitalize the canister market and grow it, just as our FANTOM® FURY® and FANTOM® THUNDER® vacuums have done in the premium-priced segment of the upright market. Not only is the visual design of our product unlike any canister on the U.S. or Canadian markets today, but it will be the only one with our patented, dual-cyclonic technology and unique STAIRHUGGER™ feature that allows it to sit on a step while the user vacuums stairs, a real benefit to the user and a real advancement in design.

The FANTOM® LIGHTNING® canister vacuum will come with a 6-foot, electrified hose and metal wand, which will attach to a powerhead that features a rotating brush for cleaning carpets. The rotating brush can be turned off for cleaning bare floors. The powerhead will have an electronic system that will turn the rotating brush off and prevent the drive belt from breaking, should the rotating brush become jammed. Additional standard features will include a retractable power cord, three cleaning tools stored on-board, and a special, ergonomically designed handle. And, of course, just like our upright vacuums, our new entry will have a certified HEPA filter, which cleans air exiting the machine to a very high level, effectively capturing 99.97% of all particles which flow through it down to 0.3 microns in size.

Our plan is to launch this product using the same successful advertising and marketing strategies that have worked so well for us with our upright machines. That is, we plan to advertise the FANTOM® LIGHTNING® canister on television using a 30-minute direct-response infomercial and short-form, direct-response spots, aimed nationally across major urban markets in the United States and Canada. We plan to consider other forms of direct-response advertising as well. We will seek distribution of the vacuum with our current major retailers as well as with several hundred independent vacuum dealers.

To accommodate the production of this new product in our Welland plant, the Company is installing a fourth self-paced, automated assembly line. Almost all of the FANTOM® LIGHTNING® vacuum's tooling, assembly, sub-assembly and component-parts will be produced inside North America, as is the case with our current upright vacuums.

THE FANTOM® VACUUM FAMILY

FANTOM® FURY®

FANTOM® THUNDER®

FANTOM® LIGHTNING®

Considering Our Long-Term Future

As we look into the future, we are confident that the plans for the innovative new products we currently have in place, along with our improved manufacturing lines and procedures, recently acquired information-technology systems, and our vibrant management team will serve us well in managing our growth over the immediate and mid-term future. But growth is never a guaranteed commodity. It must be planned for with the hard eyes of reality. And so, we must begin to diversify, taking full advantage of our strengths, so that we have a range of different products and technologies upon which to grow.

The challenge before us, then, is to recognize the core competencies that presently exist within our Company and to seek new product lines that will allow us to capitalize on these competencies. For example, we are an excellent manufacturer of consumer, durable products. We have mastered the skills needed to sell consumer products successfully using direct-response marketing tactics, and have built up a solid infrastructure of electronically linked advertising agencies, in-bound telemarketers, and credit-card processing and product-fulfillment firms. Also, we have excellent relationships with, and skills in selling and distributing to, mass merchants, catalog and catalog-showroom retailers, warehouse clubs, and home-shopping television networks throughout the United States and Canada. These skill-sets are not easily acquired, and we intend to take advantage of them as we search for new product lines that will allow us to grow in the years to come.

We thank our customers, employees, shareholders and suppliers for their support.

On behalf of the Board,

Kenneth Kelman

Kenneth Kelman
Chairman of the Board

Allan Millman

Allan D. Millman,
President and Chief Executive Officer

This discussion and analysis should be read in conjunction with the financial statements and related notes included in the 1997 annual report to shareholders.

RESULTS OF OPERATIONS

Sales

The Company's sales in fiscal 1997 increased 53% from the previous year to $150.2 million. Selling prices remained relatively unchanged from fiscal 1996 and therefore the increase in dollar sales was primarily attributable to increased unit volume. Shipments to the United States accounted for 97% of total revenue compared to 95% for fiscal 1996. Shipments of FANTOM® vacuums, including accessories, accounted for 98% of total revenue compared to 94% for the previous year.

The distribution of revenue between the United States and Canada, by retailers (including distributors) and direct-response programs, was as follows:

Revenue

(Millions of Dollars)

	United States		Canada		Total	
	1997	1996	1997	1996	1997	1996
Retailers	123.6	74.8	3.6	5.2	127.2	80.1
Direct-Response	22.3	18.4	0.7	-	23.0	18.4
Total	145.9	93.2	4.3	5.2	150.2	98.4

Shipments to retailers in the United States in fiscal 1997 increased 65% from the previous year. The increase was due to two new FANTOM® models introduced in fiscal 1996 — the FANTOM® FURY® and FANTOM® THUNDER® vacuums — being in the Company's line-up of products for all of fiscal 1997, as well as expanded listings, a greater number of promotional events, and the cumulative effect of the Company's direct-response advertising. Aggregate sales to the Company's five largest customers were $91.1 million in fiscal 1997 compared to $60.4 million in fiscal 1996.

Shipments to retailers in Canada in fiscal 1997 declined 31% from the previous year to $3.6 million. Shipments of FANTOM® vacuums increased to $1.1 million from $0.2 million in the previous year, but this gain was offset by a decline in sales of stick vacuums.

Direct-response sales of FANTOM® vacuums in fiscal 1997 increased 25% to $23.0 million, with 97% of these sales being in the United States compared to 100% in fiscal 1996. Media spending amounted to $11.3 million in fiscal 1997 compared to $6.7 million in the previous year and essentially all of the spending was for television time, utilizing 30-minute and 60- and 120-second formats.

Cost of Goods Sold

The percentage of cost of goods sold as a function of sales was 64.1% in fiscal 1997 compared to 67.6% for the previous year. The decrease, despite a higher portion of sales being to retailers rather than to end-users by direct-response television, was due to a wide range of cost reduction activities. These activities encompassed material price reductions from suppliers, productivity gains in assembly, and management of inventory and improvements in overall efficiencies assisted by both the use of kanbans for certain raw materials and the SAP enterprise-information-technology system.

Selling, General and Administrative Expenses

Selling, general and administrative expenses, as a percentage of sales, increased to 28.0% in fiscal 1997 from 25.8% in fiscal 1996. Direct-response expenses associated with the purchase of media time and the mailing out of information kits increased to $12.5 million from $7.3 million in fiscal 1996. Co-op advertising spending (which is advertising controlled by the retailer which includes the supplier's product and for which the supplier agrees to pay a portion of the costs) increased to $5.1 million from $3.6 million to support a significant increase in promotional events. Sales commissions increased to $1.7 million from $0.8 million. Expenses related to warranty activity and the refurbishing of returns increased to $3.7 million from $1.4 million in the previous year. Costs associated with insurance for receivables, bad debts and allowances for doubtful and unreconciled accounts increased to $2.6 million from $0.9 million.

Net Income

The net income for fiscal 1997 was $7.4 million compared with $5.2 million for fiscal 1996. The improvement was due mainly to the large increase in sales and the reduction in cost of goods sold as a percentage of sales, partially offset by the increase in selling, general and administrative expenses as a percentage of sales and by tax provisions of $4.1 million compared with only $0.5 million in fiscal 1996.

FINANCIAL CONDITION

During fiscal 1997 there was a cash generation from operations of $5.4 million. Non-cash operating working capital increased by $4.5 million due mainly to increases in trade accounts receivable ($6.9 million), other receivables ($1.8 million) and inventory ($1.1 million) net of a decrease in prepaid expenses ($0.9 million), increases in payables and accruals ($2.3 million) and an increase in income taxes payable ($2.1 million). Items not requiring cash included depreciation of $1.0 million and a deferred tax provision of $1.5 million.

Cash in the amount of $6.9 million was provided from equity infusions. On June 27, 1997 the Company completed a private placement of 500,000 special warrants at $14.00 per special warrant for gross proceeds of $7.0 million. Costs of the special warrant offering are anticipated to amount to $0.5 million. An additional $0.4 million of equity was provided from the exercise of stock options and broker compensation warrants.

During fiscal 1997, the Company invested $5.9 million in capital expenditures. These expenditures were mainly for tooling and assembly equipment to support the increased demand for the Company's existing FANTOM® vacuums; to modernize assembly operations at the Company's Welland, Ontario plant; for tooling for the Company's new FANTOM® LIGHTNING® canister vacuum scheduled for launch in Fall 1997; and for software and hardware to support advances in information technology.

The Company's net cash position as at June 30, 1997 was $4.7 million compared with a net loan payable of $1.6 million at June 30, 1996. Key ratio's improved from the previous year as follows:

As of June 30	1997	1996
Current Assets to Current Liabilities	1.95	1.57
Total Liabilities to Tangible Net Worth	0.77	1.14

Effective September 30, 1996 the Company arranged a new credit facility with a Canadian chartered bank which currently allows the Company to borrow up to a maximum of $13.0 million for general operating requirements and a further $4.0 million for capital expenditures. Interest on the operating line is at the prime rate of the Canadian chartered bank; interest on the capital line is at prime plus 1/2%. There are no service or administrative fees. The availability on the operating loan is subject to a formula based upon trade-receivable and inventory levels. Both loans are secured by a general assignment of book debts, a general security agreement and a mortgage over the Company's assets. The facility was fully available but unused as at June 30, 1997. Prior to the current agreement becoming effective, the Company had a financing agreement with Commcorp Financial Services Inc. of Burlington, Ontario. The interest rate payable was the prime rate of a Canadian chartered bank plus 2%. During the term of the agreement there was also a service and administration fee payable, calculated as a percentage of sales. This fee for the period the agreement was in effect during fiscal 1997 was $0.3 million compared to $0.9 million for all of fiscal 1996.

OUTLOOK

The Company believes that its FANTOM® vacuum line is continuing to grow in popularity in the United States, and is beginning to grow in Canada as a result of the Company's advertising campaigns, broadened exposure among retailers and word-of-mouth endorsements by satisfied customers.

The Company intends to focus on increasing its sales of FANTOM® vacuums in the United States and Canada by:

(a) continuing to focus on expanding distribution and promotional activity for its existing models with retailers;

(b) continuing to employ direct-response television, and to explore other direct-response formats, not only to generate direct sales but also to build broad-scale consumer awareness and demand for FANTOM® products at the retail level; and

(c) developing and introducing new vacuum-cleaning products utilizing the Company's proprietary, dual-cyclonic technology.

The Company has various agreements with the licensor of its dual-cyclonic technology which provide the Company with the exclusive right (except for a special-purpose license to a direct-marketing company) to sell upright vacuum-cleaning devices utilizing the dual-cyclonic technology in the United States and Canada, the exclusive right to sell canister and backpack products utilizing the technology in the United States and Canada, and the non-exclusive right to sell upright dry-powder carpet shampooers utilizing the technology in the United States and Canada. The first of the basic patents in the U.S. for the dual-cyclonic technology does not expire until June 2003.

The Company plans to introduce the FANTOM® LIGHTNING® canister vacuum in Fall 1997. Due to the uncertainties associated with a new product launch, it is not possible to forecast sales of this product, or its effect on net income, with any reasonable degree of accuracy. Up-front spending for design and development, tooling, assembly equipment and the production of a new 30-minute TV infomercial and short-form (60- and 120-second) TV spots is expected to amount to approximately $5.0 million. Of this amount, $2.1 million was incurred in fiscal 1997. The Company plans to manufacture the FANTOM® LIGHTNING® product in its Welland, Ontario facility.

The Company is pursuing the development of other new product concepts for vacuum cleaners based on its proprietary dual-cyclonic technology; however, it is not possible at this early stage of the development process to forecast sales, impact on net income or capital requirements associated with these concepts. The Company is also exploring the possibility of acquiring other product lines, or technology which could lead to new products, which fit with its core competencies. The Company is not able at this time to estimate the costs or impact on its business of making such an acquisition.

Given that the Company's sales occur mainly in the United States, but manufacturing takes place in Canada, the Company's results are sensitive to changes in the exchange rate between the Canadian and U.S. dollar. To help offset the effect of adverse currency fluctuation, the Company maintains a hedging program consisting mainly of the purchase of forward contracts to sell U.S. dollars. As of June 30, 1997 the Company held forward contracts to sell $37.5 million U.S. dollars, expiring at various dates through December, 1997 at an average price of $1.3679 Cdn. A protracted rise in the relative value of the Canadian dollar would have a negative effect on net income for the Company. Based on the Company's fiscal 1997 results, a rise in value of the Canadian dollar of 1 cent, without the protection of hedging, would adversely affect net income by approximately $0.7 million.

The electric floor-care industry is highly competitive and includes, among others, the following major competitors: Bissell Inc.; Eureka Company; The Hoover Company; Matsushita Appliance Corporation; and Royal Appliance Mfg. Co. Some of these competitors have recently introduced new products which will compete at similar price points with the Company's FANTOM® FURY® and FANTOM® THUNDER® vacuums. In addition, one such product incorporates a form of cyclonic filtering system. The Company is uncertain what effect these new competitive products, or future ones which could be introduced, will have on its sales or net income.

The Company believes it is positioned to realize further cost savings in manufacturing as a result of programs initiated in fiscal 1997 and new programs anticipated to be initiated in fiscal 1998. The savings are expected to occur mainly from material price reductions from suppliers, productivity gains in assembly, and efficiencies associated with increased levels of output.

Management's Responsibility For Financial Reporting

The accompanying financial statements of Fantom Technologies Inc. have been prepared by the management of the Company who are responsible for their integrity and objectivity. To fulfill this responsibility, the Company maintains appropriate systems of internal control, policies and procedures to ensure that its reporting practices and accounting and administration procedures are of high quality. The financial information presented throughout this Annual Report is consistent with the information contained in the financial statements.

The Company's Audit Committee is appointed by the Board of Directors annually. This Committee meets annually with management, as well as the independent auditors, to satisfy itself that management and the independent auditors are each properly discharging their responsibilities, and to review the financial statements and the independent auditors' report. The Audit Committee reports to the Board of Directors prior to the Board approving the financial statements for issuance to the shareholders.

The financial statements have been examined by KPMG, the independent auditors, on behalf of the shareholders. Their report outlines the nature of their examination and expresses their opinion on the financial statements of the Company.

Allan D. Millman, *President and Chief Executive Officer*
August 1, 1997

Auditors' Report to the Shareholders

We have audited the consolidated balance sheets of Fantom Technologies Inc. (formerly Iona Appliances Inc.) as at June 30, 1997 and 1996 and the consolidated statements of income and retained earnings and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at June 30, 1997 and 1996 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

KPMG, *Chartered Accountants*
Hamilton, Canada
August 1, 1997

Consolidated Statements of Income and Retained Earnings

FANTOM TECHNOLOGIES INC.

Years ended June 30, 1997 and 1996

	1997	1996
Sales	$ 150,213,517	$ 98,428,527
Cost of goods sold	96,246,860	66,586,407
	53,966,657	31,842,120
Expenses:		
Selling, general and administrative	41,999,459	25,409,225
Finance charges	464,595	718,045
	42,464,054	26,127,270
Income before income taxes	11,502,603	5,714,850
Income taxes (note 9)		
Current	2,675,200	160,000
Deferred	1,466,800	344,200
	4,142,000	504,200
Net income	7,360,603	5,210,650
Retained earnings (deficit) at beginning of year	337,502	(4,873,148)
Retained earnings at end of year	$ 7,698,105	$ 337,502
Net income per share (note 11)		
Basic	$ 0.88	$ 0.72
Fully diluted	$ 0.86	$ 0.69

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheets

[illegible] TECHNOLOGIES INC.

At June 30, 1997 and 1996

	1997	1996
ASSETS		
Current assets:		
Cash and short term deposits	$ 4,698,156	$ 339,768
Trade accounts receivable	24,110,635	17,204,654
Other receivables	3,543,762	1,709,628
Inventories (note 2)	14,930,359	13,874,909
Prepaid expenses	802,093	1,729,954
	48,085,005	34,858,913
Property, plant and equipment, net (note 3)	12,675,185	7,807,926
	$ 60,760,190	$ 42,666,839
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Loan payable (note 4)	$ —	$ 1,979,858
Trade accounts payable	16,384,518	14,477,577
Other payables and accruals	5,730,879	5,368,986
Income taxes payable	2,300,306	160,000
Current portion of capital lease obligations (note 5)	259,319	219,036
	24,675,022	22,205,457
Capital lease obligations, less current portions (note 5)	238,273	378,710
Deferred income taxes	1,426,200	123,200
Shareholders' equity:		
Share capital (note 6)	20,013,790	19,621,970
Special warrants (note 7)	6,708,800	—
Retained earnings	7,698,105	337,502
	34,420,695	19,959,472
	$ 60,760,190	$ 42,666,839

Commitments (note 10)

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Kenneth Kelman *Director* Allan Millman *Director*

Consolidated Statements of Changes in Financial Position

FANTOM TECHNOLOGIES INC. — Years ended June 30, 1997 and 1996

	1997	1996
CASH PROVIDED BY (USED FOR):		
Operations:		
Net income	$ 7,360,603	$ 5,210,650
Items not requiring cash:		
Depreciation	979,003	371,488
Amortization of deferred charges	—	486,298
Loss (gain) on sale of property, plant and equipment	52,153	(17,492)
Deferred tax provision	1,466,800	344,200
Change in non-cash operating working capital (note 12)	(4,458,564)	(5,068,068)
	5,399,995	1,327,076
Financing:		
Proceeds from capital leases	160,334	616,480
Payments on capital leases	(260,488)	(76,410)
Issuance of common shares and special warrants	7,100,620	6,720,730
Deferred tax benefit related to issuance of special warrants	(163,800)	(221,000)
	6,836,666	7,039,800
Investments:		
Additions to property, plant and equipment	(5,910,165)	(5,272,567)
Change in non-cash working capital relating to investments (note 12)	—	(435,296)
Proceeds on disposal of property, plant and equipment	11,750	17,492
	(5,898,415)	(5,690,371)
Increase in cash position	6,338,246	2,676,505
Cash position at beginning of year	(1,640,090)	(4,316,595)
Cash position at end of year	$ 4,698,156	$ (1,640,090)

Cash position is defined as cash and short term deposits less loan payable.

See accompanying notes to consolidated financial statements.

The Company is incorporated under the Business Corporations Act (Ontario). The principal business activities are the design, manufacture and sale of vacuum-cleaning devices. On May 1, 1997, Iona Appliances Inc. legally changed its name to Fantom Technologies Inc.

1. SIGNIFICANT ACCOUNTING POLICIES:

These financial statements have been prepared on the basis of accounting principles generally accepted in Canada. The most significant of the policies followed by the Company are as follows:

(a) Basis of consolidation:

The consolidated financial statements include the accounts of the Company's 100% owned subsidiary, Fantom Technologies Direct, Inc.

(b) Inventories:

Inventories are stated at the lower of cost (first-in, first-out method) and net realizable value.

(c) Property, plant and equipment:

Property, plant and equipment are stated at cost. Depreciation is computed by the straight-line method over the estimated useful asset lives at the following rates:

Asset	Rate
Building	2.5%
Machinery and equipment	10.0%
Tools and dies	10.0% to 25.0%
Furniture and fixtures	10.0%
Computer equipment	20.0%

(d) Amortization of equipment under capital lease:

Amortization of equipment under capital lease is included in depreciation expense. Such amortization is computed by the straight-line method using rates of 10% to 20% per year.

(e) Research and development:

Expenditures for research are expensed as incurred. Expenditures for development are capitalized when applicable, otherwise they are expensed as incurred. No development expense has been capitalized in 1997 or 1996.

(f) Pension costs:

The assets of the defined benefit pension plans are recorded at market values. The pension expense for the year includes adjustments for plan amendments and experience gains and losses which are being amortized on a straight-line basis over the expected average remaining service life of each plan's participants.

(g) Segmented information:

The Company operates in one industry segment, being the design, manufacture and sale of vacuum-cleaning devices and manufactures only in Canada. Sales made to customers located in the United States amounted to $145,857,000 (1996: $93,223,000).

Sales to one customer for the year ended June 30, 1997 amounted to approximately 29% (1996: 33%) of total Company sales. Sales to another customer for the year ended June 30, 1996 amounted to approximately 12%. At June 30, 1997 receivables outstanding from these sales were $5,264,000 (June 30, 1996: $8,462,000).

(h) Foreign currency translation:

The translation of foreign currency denominated balance sheet accounts is performed using current exchange rates in effect at the balance sheet date and for sales and expense accounts using average exchange rates during the period. The gains or losses resulting from translation are included in the results of operations for the period.

(i) **Revenue recognition:**

Sales and related costs are recorded by the Company upon shipment of products.

(j) **Warranties:**

The Company records a warranty accrual at the time of sale for estimated claims. The warranty on the Fantom products is for two years. The warranty on other products is generally for one year. It is the Company's practice to classify the entire warranty accrual as a current liability.

(k) **Use of estimates:**

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets, liabilities, revenue and expenses, and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

(l) **Derivative financial instruments:**

The Company uses derivative financial instruments to reduce the risks related to exchange rate fluctuations on certain transactions. Accordingly, the Company defers any unrealized gains and losses on these instruments until such time that the underlying transactions are realized.

2. INVENTORIES:

Inventories are summarized as follows:

	1997	1996
Raw materials and work-in-process	$ 4,458,126	$ 7,575,710
Finished goods	10,472,233	6,299,199
	$ 14,930,359	$ 13,874,909

3. PROPERTY, PLANT AND EQUIPMENT:

	Cost	Accumulated depreciation	1997 Net book value	1996 Net book value
Land	$ 81,204	$ —	$ 81,204	$ 81,204
Buildings	987,824	175,938	811,886	581,919
Machinery and equipment	3,310,258	486,392	2,823,866	1,624,259
Tools and dies	6,406,080	2,491,483	3,914,597	3,345,570
Furniture and fixtures	636,773	203,580	433,193	449,952
Construction in progress	2,540,306	—	2,540,306	1,038,498
Equipment under capital lease	776,815	143,645	633,170	686,524
Computer equipment	1,540,318	103,355	1,436,963	—
	$ 16,279,578	$ 3,604,393	$ 12,675,185	$ 7,807,926

4. LOAN PAYABLE:

Effective September 30, 1996, the Company arranged a new credit facility with a Canadian chartered bank which currently allows the Company to borrow up to a maximum of $13,000,000 for general operating requirements subject to an availability formula based on trade accounts receivable and inventory and up to an additional $4,000,000 for capital expenditures. Interest on the operating line is calculated at the prime rate of the Canadian chartered bank (4.75% at June 30, 1997) and on the capital line at prime rate plus 1/2%. Any borrowings under this agreement are secured by a general assignment of book debts, a general security agreement and a mortgage over all the Company's assets.

Prior to the current agreement becoming effective, the Company had a financing agreement with Commcorp Financial Services Inc. The interest rate on the loan payable at June 30, 1996 was 8.50%. During the term of the agreement a service and administration fee, calculated as a percentage of sales, was also payable. This fee for the year ended June 30, 1997 was $308,000 (1996: $897,000) and is included in selling, general and administrative expenses.

The effective interest rate on the Company's borrowings under these agreements for the year ended June 30, 1997 was 5.6% (1996: 9.5%).

5. CAPITAL LEASE OBLIGATIONS:

Future minimum lease payments, by year and in aggregate, under capital leases are as follows:

	1997	1996
Fiscal year:		
1997	$ —	$ 256,111
1998	289,147	229,311
1999	232,749	172,912
2000	15,192	3,014
Total minimum lease payments	537,088	661,348
Amount representing interest (at rates of 6.5% to 16.4%)	39,496	63,602
Present value of net minimum lease payments	497,592	597,746
Less current portions	259,319	219,036
	$ 238,273	$ 378,710

6. SHARE CAPITAL:

(a) Capital stock:

The authorized share capital of the Company consists of an unlimited number of common shares, an unlimited number of class A, preferred shares, issuable in series, of which 1,581,748 (1996: 1,581,748) series 1, non-redeemable, non-retractable convertible class A preferred shares have been issued and an unlimited number of class B, preferred shares, issuable in series.

The issued share capital of the company is as follows:

	1997	1996
Common shares (note 6(b))	$ 18,111,532	$ 17,719,712
1,581,748 (1996: 1,581,748) series 1, Class A, preferred shares	1,902,258	1,902,258
	$ 20,013,790	$ 19,621,970

The series 1, class A preferred shares are fully convertible into common shares of the Company on a share-for-share basis, subject to comprehensive anti-dilution protection for the holders of the series 1, class A preferred shares and are entitled to receive dividends equally and ratably with the common shares. At June 30, 1997 and 1996, the 1,581,748 series 1, class A preferred shares are convertible into 1,598,915 common shares. Mandatory conversion is required on May 1, 2000 if the market price per share exceeds a base price.

(b) Changes in common shares:

	Shares	Amount
Outstanding at June 30, 1995	5,049,500	$ 10,775,951
Conversion of preference shares to common shares	184,943	220,031
Exercise of warrants for cash	300,000	753,000
Shares issued from treasury for cash	1,000,000	5,668,755
Exercise of Compensation Warrants	26,400	161,700
Exercise of stock options	102,250	140,275
Outstanding at June 30, 1996	6,663,093	17,719,712
Exercise of Compensation Warrants	33,600	199,820
Exercise of stock options	115,000	192,000
Outstanding at June 30, 1997	6,811,693	$ 18,111,532

On December 20, 1995, the Company issued and sold 1,000,000 special warrants of the Company for gross proceeds of $6,000,000 pursuant to an underwriting agreement between the Company, Sprott Securities Limited and Newcrest Capital Inc. (collectively, the "Underwriters"). Subsequent to receipt of the final prospectus by the securities regulatory authorities on March 29, 1996, the special warrants were exercised and 1,000,000 common shares were issued. Costs of the offering, net of estimated corporate income tax recoveries of $221,000, were $331,245.

Under the agreement the Underwriters received a fee of $360,000 and 60,000 common share purchase warrants (the "Compensation Warrants"). Each Compensation Warrant entitled the holder thereof to purchase one common share of the Company at a price of $6.125 per share.

(c) **Stock option plans:**

The Company has established a Key Employees' Stock Option Plan and an Outside Director Share Option Plan. Options to purchase common shares of the Company under the Plans may be granted by the Board of Directors to certain employees and directors of the Company. In addition, the Board of Directors may grant options to independent consultants.

The exercise price for the common shares covered by the foregoing option arrangements is determined by the Board of Directors, but must not be less than the fair market value of the common shares at the time of the grant of the option.

Changes in the outstanding stock options relating to the plans.

	Number of Shares	Option Price Range Per Share
Outstanding at June 30, 1995	243,000	$ 1.10 to $ 4.80
Granted	90,000	$5.00 to $ 8.50
Cancelled	(3,250)	$ 2.70
Exercised	(102,250)	$ 1.10 to $ 3.90
Outstanding at June 30, 1996	227,500	$ 1.10 to $ 8.50
Granted	350,000	$9.30 to $12.30
Cancelled	(2,500)	$ 3.90
Exercised	(115,000)	$ 1.10 to $ 4.80
Outstanding at June 30, 1997	460,000	$3.90 to $12.30

The outstanding options have an average exercise price of $9.66 and expire at various dates in the period from October 30, 1998 to April 16, 2002.

7. SPECIAL WARRANTS:

On June 27, 1997, the Company issued and sold 500,000 special warrants of the Company for gross proceeds of $7,000,000 pursuant to an underwriting agreement between the Company, Sprott Securities Limited and Newcrest Capital Inc. (collectively, the "Underwriters"). Under the agreement the Underwriters received a fee of $280,000 on the terms described below.

The gross proceeds of the private placement of the special warrants were $7,000,000. The net proceeds will be $6,545,000, after deducting the Underwriters' fee of $280,000 and the estimated expenses of the offering of $175,000, which has been reflected in the financial statements as at June 30, 1997. Estimated corporate income tax recoveries, relating to the issue costs, of $163,800 have also been reflected in the financial statements as at June 30, 1997.

The special warrants may be exercised at any time on or before 5:00 p.m., Toronto time, on the earlier of (i) the fifth business day after the day (the "Qualification Date") on which the holders of special warrants have received formal notification that receipts have been issued by each of the British Columbia, Manitoba and Ontario securities commissions for a final prospectus (the "Prospectus") of the Company qualifying the distribution of the 500,000 common shares issuable upon exercise of the special warrants; and (ii) June 29, 1998.

In the event the receipt for the Prospectus has not been received by October 27, 1997, (the "Clearing Deadline") the holders of the special warrants will be entitled to acquire, without additional consideration, 1.1 common shares of the Company instead of one common share.

8. PENSION PLANS:

The Company has established two pension plans which cover substantially all its employees. One plan is a defined benefit plan and the other has both a defined benefit and a defined contribution component. As at June 30, 1997 the accrued benefit obligation of the defined benefit pension plans was approximately $3,561,000 (June 30, 1996: $3,797,000) and the market value of the related pension fund assets was $3,862,000 (June 30, 1996: $3,837,000). The aggregate pension expense for the year ended June 30, 1997 was $348,000 (1996: $224,000).

9. COMPONENTS OF CONSOLIDATED INCOME TAXES:

	1997	1996
Provision based on statutory combined federal and provincial income tax rates (1997: 44.6%, 1996: 44.3%)	$ 5,130,000	$ 2,531,200
Manufacturing and processing profits deduction	(1,035,000)	(274,000)
Recognition of tax benefits not previously recognized	—	(1,913,000)
Provincial minimum tax	—	160,000
Other	47,000	—
	$ 4,142,000	$ 504,200

10. COMMITMENTS:

(a) Under various technology transfer agreements, the Company has an obligation to pay royalties based upon sales of products using dual-cyclonic technology. In some instances, the Company must pay a minimum annual royalty in order to preserve the exclusive nature of its rights. Minimum royalty payments for 1998 amount to approximately $665,000. The agreements extend until the basic patents expire with bi-annual adjustments in the royalty rate based on the change in the consumer price index. The first of the basic patents does not expire until 2003.

(b) At June 30, 1997 the Company has committed to spend $3,664,000 for equipment and tooling.

11. NET INCOME PER SHARE:

Basic net income per share has been calculated using the weighted monthly average number of common and series 1, class A preferred shares outstanding during the respective years. These were 8,363,599 shares for 1997 and 7,232,746 shares for 1996.

The 1997 net income for the calculation of fully diluted net income per share has been increased by $73,000 (1996: $63,000) being the after-tax effect of the investment at 6% of the proceeds of the exercise of the stock options and warrants mentioned in note 6, and assuming that the exercise occurred at the later of the beginning of the year and the issue date. The number of shares outstanding for purposes of calculating fully diluted net income per share was 8,621,003 for 1997 and 7,681,768 for 1996.

12. CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION:

Changes in non-cash operating working capital are as follows:

	1997	1996
Trade accounts receivable	$ (6,905,981)	$ (6,722,795)
Other receivables	(1,834,134)	(619,035)
Inventories	(1,055,450)	(5,383,146)
Prepaid expenses	927,861	(1,235,417)
Trade accounts payable	1,906,941	6,515,289
Other payables and accruals	361,893	1,781,740
Income taxes payable	2,140,306	160,000
	$ (4,458,564)	$ (5,503,364)
Relating to operating activities	$ (4,458,564)	$ (5,068,068)
Relating to investing activities	–	(435,296)
	$ (4,458,564)	$ (5,503,364)

13. FINANCIAL INSTRUMENTS:

(a) Foreign currency rate risk:

The Company realizes a significant portion of its sales in foreign currencies and enters into various types of foreign exchange contracts in managing its foreign exchange risk. The Company does not hold or issue financial instruments for trading purposes. At June 30, 1997, the Company held forward foreign exchange contracts with an aggregate notional amount of $37,500,000 to sell U.S. dollars at an average rate of 1.3679 Canadian per U.S. dollar expiring at various dates to December, 1997. At June 30, 1997, these contracts had a negative fair value of $192,500 based on quotations from the Company's bank of which $61,000 is reflected in other payables and accruals and the recognition of the remainder has been deferred to match the recognition of the anticipated sales being hedged.

(b) Credit risk:

The Company does not have a significant exposure to any individual customer other than the customer previously noted in note 1 (g). The Company reviews a new customer's credit history before extending credit and conducts regular reviews of its existing customers' credit performance. The Company currently obtains credit insurance coverage from Export Development Corporation on most domestic and export retail sales. An allowance for doubtful accounts is established based upon factors surrounding the credit risk of specific customers, historical trends and other information. The allowance for doubtful accounts at June 30, 1997 was $583,773 (1996: $129,175).

14. COMPARATIVE FIGURES:

Certain of the comparatives figures have been reclassified to conform with the current year's presentation.

Directors and Officers

FANTOM TECHNOLOGIES INC.

DIRECTORS

Arthur H. Crockett	*Toronto, Ontario, Corporate Director*
Maxwell Goldhar	*Toronto, Ontario, Vice Chairman, OSF Inc.*
Kenneth Kelman	*Toronto, Ontario, Chairman of the Board of the Company*
Rikki Meggeson	*North York, Ontario, Vice President, First Canada Financial Corporation Limited*
Allan D. Millman	*North York, Ontario, President of the Company*
C. George Scala	*Beverly, Massachusetts, Corporate Director*
Alan Steinert Jr.	*Cambridge, Massachusetts, Special Assistant to the Secretary of the Executive Offices of Health and Human Services of the Commonwealth of Massachusetts*

OFFICERS

Kenneth Kelman	*Toronto, Ontario, Chairman of the Board*
Allan D. Millman	*North York, Ontario, President and Chief Executive Officer*
Stephen J. Doorey	*Mississauga, Ontario, Vice President, Chief Financial Officer*
Alan C. Hussey	*Welland, Ontario, Vice President, Manufacturing*
Walter J. Palmer	*Toronto, Ontario, Secretary*
Joseph A. Shillington	*Welland, Ontario, Vice President, Information Technology*
Paul F. Smith	*Oakville, Ontario, Vice President, Sales*
Norman V. Soler	*Port Colborne, Ontario, Vice President, Engineering*
Nick E. Varanakis	*Sandy, Utah, Vice President, Sales*
Linda L. Watson	*Mississauga, Ontario, Vice President, Marketing*

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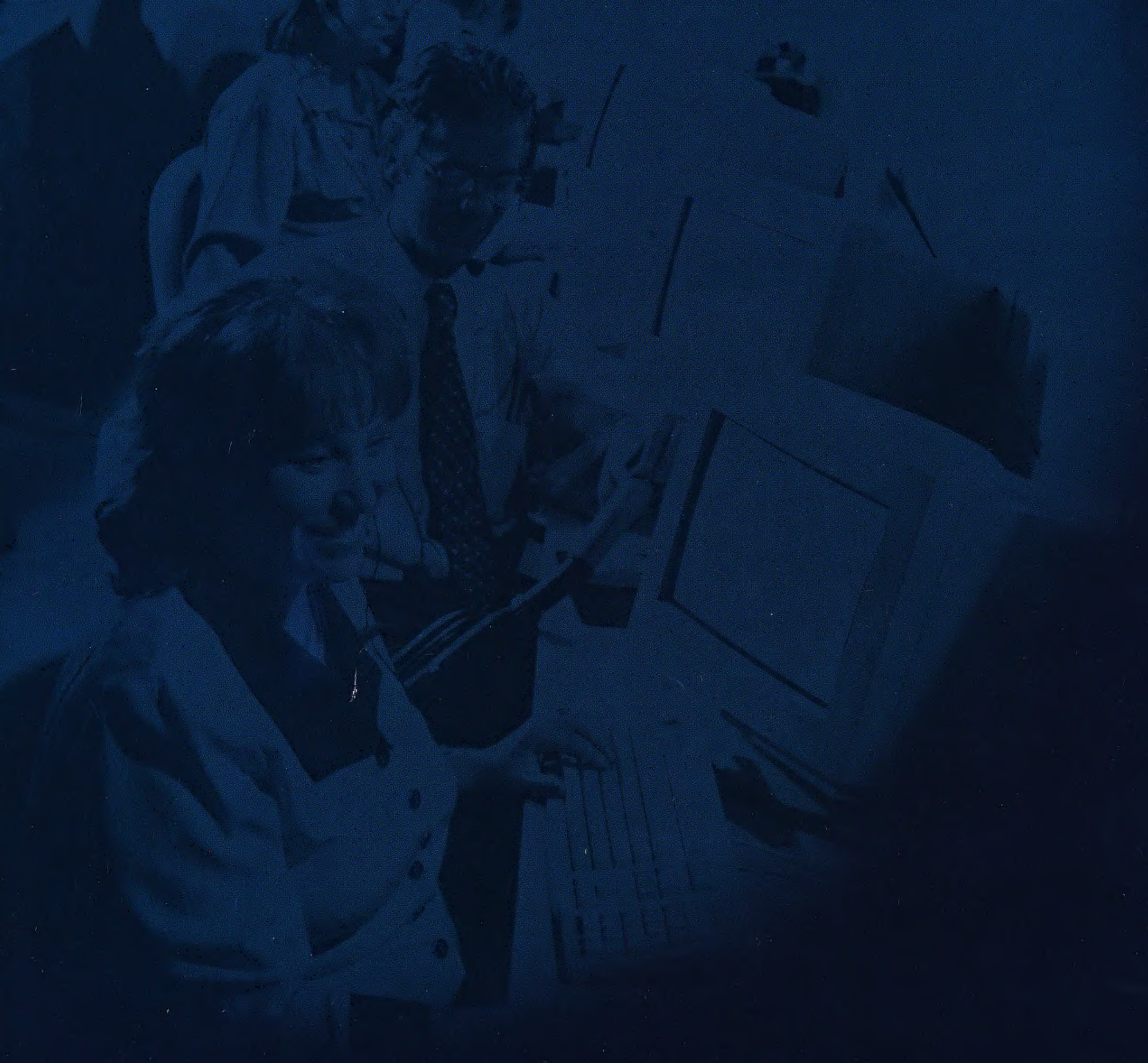
Banker: *The Bank of Nova Scotia, 177-185 St. Paul Street, St. Catharines, Ontario L2R 6T3*
General Counsel: *Fasken Campbell Godfrey, Suite 3600, Toronto-Dominion Centre, Toronto, Ontario M5K 1N6*
Transfer Agent & Registrar: *CIBC Mellon Trust Company, 393 University Avenue, 5th Floor, Toronto, Ontario M5G 1E6*

ANNUAL SHAREHOLDERS MEETING

October 23, 1997, Knightsbridge Room, The King Edward Hotel, 37 King St. East, Toronto, Ontario at 11:00 a.m.



FANTOM®

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